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The Proposed Corporate Sponsorship Regulations:

Is The Treasury Department "Sleeping With The Enemy?"

David A. Brennen*

I. Introduction

In 1993, the Treasury Department (the Treasury)¹ issued a proposed regulation outlining when money received by a charity from a corporate sponsor would be subject to federal income tax.² In defining the phrase "trade or business,"³ the proposed regulation addresses the extent to which sponsorship payments to charities will be treated by the Treasury as having been made in return for advertising on behalf of the sponsor, thus subjecting the payment to income tax.⁴ In the proposed regulation, the Treasury concludes that a charity's use of a corporate sponsor's name in the title of a charitable event is a mere acknowledgment and, thus, no advertising trade or business exists.⁵ However, if the charity — as a condition of accepting the sponsor's money — displays the sponsor's slogan at the event, an advertising trade or business exists to the extent that the slogan promotes the sponsor's product or service.⁶

Curiously, the Treasury's examples of acknowledgments in the proposed regulation do not logically follow from its regulatory definition of acknowledgment. For instance, the proposed regulation indicates that displaying a sponsor's product at a charitable event, or providing free samples to patrons, is not advertising; rather, it is an acknowledgment of the sponsor's gift. However, the definition of advertising in the proposed regulation states, in part, that "[a]dvertising includes any activity which

promotes or markets any . . . product," [unless, of course, it is classified as an acknowledgment].

⁷ Could giving away free samples of a product ever be non-promotional for the seller of that product? A rose by any other name is still a rose — is it not? This is only one of the various examples indicating that, at least with respect to sponsorship payments, the Treasury is biased in favor of charities when classifying a sponsorship payment as for either advertising or acknowledgment funds.⁸

What makes this situation even more preposterous, and rather revealing, is that the Treasury took the exact opposite position for several years preceding the proposed regulation. In its pre-1993 position, the Treasury was of the opinion that a charity's promotion of an event sponsor, much less the sponsor's product, is necessarily a taxable advertising business activity. Why the change in position? Why is the Treasury now proposing a regulation which will make life much easier for charities? Why is the Treasury agreeing to forego much-needed revenue so that charities could benefit? The most likely unstated rationale is that the Treasury caved-in to political pressure from both Congress and the charitable community.⁹

From a policy standpoint, the proposed

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regulation obviously goes too far — at least farther than what a fully informed populous would expect.¹⁰ If finalized, it will likely divert significant advertising revenues of businesses away from traditional advertising media such as non-public radio, newspaper, and television. Consequently, to the extent that these diverted dollars are treated by the Treasury as for “acknowledgments,” as opposed to “advertisements,” the Treasury will likely lose significant tax dollars.¹¹ Additionally, several tax practitioners and academics have suggested that the proposed regulation is an indication that the Treasury has “capitulated to college football bowls, museums, and symphonies.”¹² Granted, the proposed regulation represents bad policy making by the Treasury. Does bad policy-making mean that the Treasury acted beyond its legal bounds? Specifically, if finalized, will the proposed regulation represent an improper regulatory interpretation by the Treasury of the statutory term “trade or business?”

Although this political pandering by the Treasury to taxpayers is clearly bad policy, the Treasury’s action is perfectly legal. Analysis of relevant Supreme Court cases reveals that a federal agency’s interpretation of a term or issue that Congress has failed to address in legislation will be upheld if reasonable. Indeed, treasury regulations reviewed by the Supreme Court are customarily invalidated only when Congress has defined the statutory term or issue addressed by the regulation. Here, Congress has not defined the term “advertising,” nor the term “trade or business.” Thus, the Treasury’s interpretation would likely be upheld as a valid exercise of regulatory authority.

Part II of this article will outline the historical development of this so-called unrelated business income tax on charities. Part

III will show, in detail, how the Treasury’s position in the proposed regulation represents a sharp departure from its pre-1993 interpretations regarding the status of sponsorship payments and posit possible reasons for the change. Part IV shows that the Treasury’s “new” position on sponsorship payments, while an example of poor policy-making in light of the historical development of the unrelated business income tax, is legally defensible. Finally, part V suggests that the Treasury, in light of the policy concerns, should not finalize the proposed regulation. Instead, the Treasury should revert to its original position that sponsorship payments are unrelated business income if the payments amount to a “quid pro quo.”

II. Historical Rationales For The Income Tax on Charities

A. *Introduction to the Income Tax on Charities*

Before one can fully grasp the essence of what the Treasury has done in this proposed regulation, analysis of the historical development of the “special” income tax on charities is in order. Through such analysis, it becomes all too apparent that Congress had specific reasons for placing limits on what charities can do without bearing the burden of paying an income tax. The primary reason for the congressional limitation on charities is alleviation of potential economic competitive advantage for charities over non-charitable tax-paying businesses engaged in commercial (i.e., trade or business) activities.

B. *The Origin of Charities*

Prior to the imposition of a corporate income tax in 1894, all entities were exempt from federal tax by virtue of statutory omission. However, with the advent of the flat two percent

corporate income tax in 1894, § 32 of the Tariff Act of 1894 provided for the first modern-day statutory tax exemption. This early tax exemption applied to entities such as charities, churches, and schools. These exemptions continued, in a modified form, through enactment of the Revenue Act of 1913, which imposed the first constitutional federal income tax.¹³

Today, a wide variety of entities enjoy statutory exemption from the federal income tax, including charities, churches, and schools; farm cooperatives; political organizations; and homeowners associations.¹⁴ A great number of tax-exempt organizations (i.e., churches, charities and most schools and governmental entities) enjoy the added benefit of the right to receive tax-deductible contributions.¹⁵ This latter benefit is bestowed primarily on those tax-exempt "public benefit organizations" described in § 501(c)(3) of the Internal Revenue Code.¹⁶

C. Historical Development of the Unrelated Business Income Tax on Charities

Since their statutory creation in the early part of the twentieth century, charities have enjoyed a blanket exemption from federal income tax. However, in 1950 Congress correctly perceived that some charities were abusing their beneficial status.

One example of this abuse occurred in 1947, a corporation (X-corp), by using their exemption to realize economic profit at the expense of taxable competitors, organized to benefit a tax-exempt law school, acquired all of the outstanding stock of a taxable macaroni maker that later merged into X-corp. Congress sought to end such abuse through enactment of the unrelated business income tax (ubit) in

1950.¹⁷ Thereafter, the macaroni maker was operated exclusively for the benefit of X-corp and, accordingly, paid its profits over to the law school.¹⁸ Under the Supreme Court's now-abandoned destination of income test, the destination of a tax-exempt organization's income was considered to be of greater consequence than the source and use of the income for purposes of determining exemption.¹⁹ Thus, even though the macaroni maker sold the same product both before and after the merger, its income from sales after the merger was exempt from federal income tax because all profits were paid to the law school — a charity. Because of this exemption, the macaroni maker could realize a larger profit from each dollar of revenue than could a similar macaroni maker whose income was not exempt from the income tax. Therefore, by virtue of the laws of tax exemption, the macaroni maker had an unfair economic commercial advantage over its taxable competitor, prompting Congress to enact the ubit in 1950. With few exceptions, today's ubit applies to all charities.²⁰

D. Operation of the Unrelated Business Income Tax

The main purpose of the ubit is to minimize the degree of unfair commercial advantage of charities over non-charities caused by tax-exemption.²¹ The ubit attempts to accomplish this goal in various sections of Chapter 26 of the U.S. Code by taxing certain income generated by charities to the same extent that such income would be taxed if generated by a taxable non-charitable competitor engaged in a similar commercial activity. Section 511 imposes the ubit on the "unrelated business taxable income" of charities.²² Section 512 defines "unrelated business taxable income,"

generally, as gross income derived from any unrelated and regularly carried on "trade or business," less any directly attributable expenses.²³ Finally, § 513 provides that an unrelated trade or business is any "trade or business" which is not substantially related to the exercise or performance of an organization's tax exempt purpose.²⁴

E. The Treasury's Three-Part Test for Determining When Charities Owe Income Tax

In accordance with the statutory framework of subchapter F, the Treasury has promulgated regulations which outline a three-part test for determining when an amount of money received by a charity is subject to tax. Under this test, it must be established that (1) a trade or business produced income, (2) the trade or business is regularly conducted, and (3) the trade or business is unrelated to the charity's exempt function.²⁵ Thus, unless an exception²⁶ or modification²⁷ applies, a charity with taxable income²⁸ satisfying this three-part test is obligated to pay the unrelated business income tax.

The trade or business element, which is the primary focus of this article, requires that a § 162 "trade or business" produce income.²⁹ Although § 162 does not explicitly define the phrase "trade or business," the term is generally understood in tax law as referring to an activity entered into for profit.³⁰ Thus, pursuant to the regulations, when a charity mails low cost articles incident to its solicitation of charitable contributions, no § 513 trade or business activity has occurred.³¹ Presumably, mailing such articles is done without any requirement that they be returned (or paid for) or that a contribution be made by the recipient. The lack

of such conditions surrounding mail-outs indicates a predominant intent to receive contributions instead of to sell the items.

The second requirement of the three-part test is that the trade or business activity be "regularly carried on."³² In determining if a trade or business activity is regularly carried on, the regulations provide that the focus should be on the frequency and continuity with which the trade or business activity is conducted and the manner in which it is pursued.³³

In light of the purpose of the unit to equalize tax treatment of competing charitable and non-charitable businesses, comparison of frequency and manner is usually made with reference to similar taxable business activities. For example, the publication of advertisements in an event program may not be regularly carried on because of the infrequency of the event and, correspondingly, the publication of the advertisements. However, systematic and consistent promotion of the event annually may result in a finding that the advertising trade or business is "regularly carried on."³⁴ Presumably, this is because the type of advertising and the efforts utilized in producing the advertisements, potentially, takes business away from taxable advertising competitors such as newspapers, magazines, and radio.³⁵

The third requirement, that the trade or business be "unrelated," is satisfied if the trade or business is not substantially related to the charity's exempt purpose.³⁶ Here, a comparison is made of the causal relationship between the trade or business activity that generated the income and the accomplishment of the charity's exempt purpose. Thus, unless a business activity contributes importantly to the accomplishment of a charity's exempt purpose, the business activity is "unrelated" for purposes of the third part of

the test.³⁷

F. Congressional Focus on Sponsor Advertising by Charities as a Trade or Business

In 1969, Congress once again faced a problem regarding unfair competition spawned by tax exemption. The problem was how to deal with businesses that were carried on as part of a complex of activities which, in the aggregate, were carried on in the exercise of an exempt function.³⁸ Congress referred specifically to advertising in tax-exempt periodicals, magazines, and the like as a prime example of the problem.³⁹ If the income generated by selling such advertising by charities goes untaxed, then charities have a distinct commercial advantage over taxable entities selling similar advertising.⁴⁰ Furthermore, this advantage is caused solely by the status of the favored entity as tax exempt.⁴¹

In an effort to solve this problem, Congress enacted 26 U.S.C. § 513(c).⁴² Section 513(c)⁴³ provides that an activity does not lose its identity as a "trade or business" simply because it is carried on within a larger aggregate of similar related⁴⁴ activities which, in total, constitute a charitable activity.⁴⁵ For example, even though the National Collegiate Athletic Association's Final Four Basketball Tournament is a charitable event, any advertising done by NCAA on behalf of a Final Four sponsor is a "trade or business" activity.⁴⁶ Furthermore, although § 513(c) is entitled "Advertising, Etc., Activities," it is clear from the legislative history that it is intended to cover all commercial exploitations of an exempt function — not just advertising.⁴⁷ Thus, the three-part test outlined in the regulations may be applied to one of a conglomerate of activities within a business or to the extent that any

activity is not exempt via § 513.⁴⁸

III. The Treasury's Treatment of Sponsorship Payments as Taxable Advertising Income (or Not) Over the Past Few Years

A. Application of the Unrelated Business Income Tax to Sponsorship Payments

Generally, a sponsorship payment is a fee paid to a charity for the purpose of funding an event or activity conducted by the charity. This article concerns the type of sponsorship payments where the sponsor receives something in return for sponsoring charitable events. The Treasury Department estimates that such payments for charitable events have increased at an annualized rate of more than 20% over the past decade, amounting to well over \$3 billion in recent years.⁴⁹

Sponsorship payments are often made on the condition that the payor receives some type of return benefit from the tax-exempt event organizer. This return benefit may be anything from a simple expression of appreciation (i.e., a mere acknowledgment), to a more complicated "quid pro quo" arrangement involving specific advertising requirements.⁵⁰ Although the line separating an acknowledgment from an advertisement may be in dispute, the impact of such a distinction is quite clear. If a sponsorship payment is for a mere acknowledgment, the payment is tax-free to the tax-exempt recipient.⁵¹ However, if the sponsorship payment is for an advertising benefit, then the payment may be taxable to the tax-exempt recipient.⁵² Thus, appropriate treatment of a sponsorship payment as either payment for an acknowledgment or payment for advertising is critical as far as the tax-exempt organizer of a charitable event is

concerned.

B. 1991: Treasury Issues Technical Advice Memorandum Concluding That Cotton Bowl Organizers Advertised on Behalf of Sponsor

On August 16, 1991, the Treasury ruled that sponsorship payments to the exempt organizers of two college football bowl games was for advertising and, thus, subject to taxation.⁵³ Technically, this technical advice memorandum (TAM) only applies to the factual situation involved therein and, therefore, may not be cited as precedent.⁵⁴ However, it has potential wider implications. This TAM is one of the few published rulings that is indicative of the Treasury's inclination, at least during 1991, to treat a wide variety of sponsorship payments as for advertising as opposed to acknowledgment. Thus, in addition to tax-exempt bowl games, the Treasury's analysis of the situation in this TAM may apply to other situations as well.

In the Mobil Cotton Bowl TAM,⁵⁵ Mobil Oil Corporation (Mobil) agreed, by contract, to make sponsorship payments to the Cotton Bowl Athletic Association (CBAA), a § 501(c)(3) charity. The payments were made in relation to CBAA's annual charitable event popularly known as the "Cotton Bowl."⁵⁶ In return for the sponsorship payment, CBAA agreed to do the following:

1. Change the name of the Cotton Bowl to the "Mobil Cotton Bowl."
2. Add the Mobil logo to the Cotton Bowl logo and use both the new name and logo, exclusively, on all Cotton Bowl press releases.
3. Imprint the new logo at a prominent place at the site of the event.
4. During the event, display Mobil's

commercial messages on an electronic sign and broadcast these messages over the public address system.

5. Void the contract, at Mobil's option, if the event is not televised.

6. Arrange for event tickets, hotel rooms, and event-related activity tickets on behalf of Mobil.⁵⁷

In the Mobil Cotton Bowl TAM, the Treasury concluded that the ubit applied to the sponsorship payments made by Mobil to CBAA. The Treasury reasoned that the payments were income from a "trade or business" because the amount of return benefit to Mobil was substantial and not a mere recognition by CBAA of Mobil's payment.⁵⁸ The Treasury rejected CBAA's argument that the return benefit was insubstantial because CBAA was required to invest very little time, effort, or expense under the contract. Instead, the Treasury recognized that the value of the advertising services rendered to Mobil by CBAA was "commensurate" with the amount of money paid by Mobil, indicating a prohibited "quid pro quo" arrangement.⁵⁹

The Treasury also noted that the CBAA's advertising trade or business was both unrelated to CBAA's exempt educational purpose and regularly carried on. The advertising business was unrelated because neither adding Mobil's logo nor the displaying of its commercial message contributed importantly to CBAA's exempt purpose.⁶⁰ Additionally, the advertising activity was regularly carried on because it was conducted over a relatively significant period of time and was systematic and consistent.⁶¹ The Treasury does not state whether both the time CBAA spent soliciting Mobil's advertising business and the time during which the advertisement aired was counted in this

“significant period of time.” However, this is a reasonable assumption given the Treasury’s positions in earlier cases where such solicitation and preparation time was indeed considered.⁶²

The Treasury’s analysis and conclusions in the Mobil Cotton Bowl TAM regarding the regularly carried on element of the § 1.513-1(a) ubit test are also notable.⁶³ In 1991, the Treasury and at least one federal circuit court disagreed as to how to apply the regularly carried on element to advertising at annual charitable events.⁶⁴ The Treasury’s position at the time was to look at preparatory and promotional efforts in conjunction with the dissemination of the advertisement itself.⁶⁵ The Tenth Circuit chose to look to the dissemination of the advertisement only.⁶⁶ The Treasury’s view is consistent with the ubit’s stated goal of lessening the competitive commercial advantage, due solely to tax exemption, of charities over taxable entities.⁶⁷ An analysis which ignores preparatory and promotional efforts ignores the reality that taxable advertising businesses engage in these very efforts in order to increase advertising profits and revenues.⁶⁸ The Treasury’s position of considering preparatory and promotional efforts recognizes this reality.

C. 1992: Treasury Issues Proposed Audit Guidelines Reaffirming It’s 1991 Position That Sponsorship Income Would Be Taxed if Significant Advertising is Performed

On January 17, 1992, just five months after it issued the Mobil Cotton Bowl TAM, the Treasury issued proposed audit guidelines regarding charitable event sponsorship payments.⁶⁹ The purpose of these guidelines was to help Treasury personnel determine whether the benefit to a charitable event sponsor was

more than a mere recognition of the sponsor’s generosity.⁷⁰ Thus, the guidelines were concerned, primarily, with the first element of the § 1.513-1(a) three-pronged test (i.e., whether income is from a § 162 trade or business). It is widely believed that the guidelines represented the Treasury’s response to the situation involved in the Mobil Cotton Bowl TAM.⁷¹

The guidelines began by generally providing that if the return benefit to a sponsor is substantial, as opposed to insubstantial, the sponsorship payments may be subject to the ubit.⁷² However, the Treasury did not outline a clear and concise rule for determining whether a return benefit was substantial or not. Instead, reflecting the approach used by the Treasury in the Mobil Cotton Bowl TAM, the guidelines suggested analysis of a list of various factors for this purpose. Some of the factors to be examined included the value of the services provided as a return benefit and the terms under which the payments and services were rendered.⁷³

Next, the guidelines stated that they did not apply to purely local charities that received “insignificant” sponsorship funds and operated with “significant amounts” of volunteer labor.⁷⁴ For example, the guidelines did not apply to little league sports teams, local theaters, or youth orchestras. The Treasury probably excluded these smaller entities from coverage because they offer little opportunity for the type of commercially competitive abuse with which the ubit is concerned. For the most part, these smaller entities are more concerned with covering costs than with making a profit and, therefore, probably lack the required profit motive. More importantly, however, the guidelines were not limited solely to college bowl games. Thus, by implication, they would

apply to all charities that received sponsorship money for charitable events.

Finally, the guidelines suggested specific items that tax personnel should examine in evaluating the significance of the return benefit.⁷⁵ Some of these items included the contract,⁷⁶ if any, between the sponsor and the charity and videos,⁷⁷ if any, of the charitable event for evidence of extensive sponsor promotion. Also, the guidelines listed factors such as use of the sponsor's name and logo in the event title and displaying the sponsors commercial message at the event as indicative of an unrelated trade or business.⁷⁸ This is a clear indication that the guidelines were prompted by the Mobil Cotton Bowl TAM.

In general, the guidelines reaffirmed the Treasury's position that arrangements involving significant advertising benefits to the sponsor of a charitable event will be looked at closely. However, at least one commentator has argued that the Treasury's focus for determining "substantial return benefit" under the guidelines was too broad.⁷⁹ Under this argument the Treasury should not have focused its attention in the guidelines on both the charity's advertising services provided and the sponsor's expected return benefit. Instead, the argument continues, the Treasury should, as suggested by the Supreme Court in *American Bar Endowment*,⁸⁰ focus solely on the advertising services provided when evaluating revenue for unit purposes.

This argument ignores the fact that the reason for the guidelines is to determine whether a § 513 trade or business exists. In the case of a sponsorship payment to a charity, the potential trade or business is that of advertising for the sponsor. Regardless of how one defines "advertising," it must necessarily involve the promotion or marketing of the sponsor's product

or service. In essence, if no agreement for substantial promotion or marketing exists, then there is probably no expectation of an advertising benefit. On the other hand, if an advertising trade or business exists, then it is the promotion or marketing for which the sponsor pays. Thus, the presence or absence of an expectation by the sponsor of an advertising benefit is critical in determining whether a "substantial return benefit" exists.⁸¹

D. 1993: Treasury Issues Proposed Regulation in which it Re-Defines Advertising "Trade or Business" By Example

On January 22, 1993, more than a year after it issued the proposed audit guidelines, the Treasury issued proposed regulations regarding when sponsorship income is subject to tax.⁸² Like the proposed audit guidelines, proposed regulation 1.513-4 addresses the issue of when sponsorship of a charitable event satisfies the "trade or business" element of the § 1.513-1(a) three-pronged test. However, unlike the proposed audit guidelines, the proposed regulation both defines the critical term "advertising" and provides numerous examples of what advertising is and what it is not.⁸³

Proposed Regulation § 1.513-4 defines advertising as follows:

[A]ny message or other programming material which is broadcast or otherwise transmitted, published, displayed or distributed in exchange for any remuneration, and which promotes or markets any company, service, facility or product. Advertising includes any activity which promotes or markets any company, service, facility or product. Advertising

does not include acknowledgments described in [1.513-4(c)].⁸⁴

Thus, at least according to the plain language of the definition, if a charity's activity either involves no promotion or marketing or if it fits the 1.513-4(c) definition of "acknowledgment," it will not be considered advertising. Presumably, this would result in a finding that the ubit does not apply to the income generated by the activity.

The Treasury chose to describe "acknowledgment" as a "mere recognition of a sponsor's payment."⁸⁵ This definition is not much different than the Treasury's statements in the Mobil Cotton Bowl TAM and the proposed audit guidelines that the return benefit is for advertising if it is more than a mere insubstantial return benefit. Accordingly, this definition provides very little additional help, if any, in determining when a sponsorship payment is for an acknowledgment versus an advertisement. Thus, for the most part, acknowledgments must be determined by reviewing the many examples and illustrations of the proposed regulation.

The first group of illustrations is an apparent attempt by the Treasury to say that simply displaying information that identifies a sponsor, with nothing more, is an acknowledgment.⁸⁶ Thus, use of the sponsor's logos or slogans and displaying a sponsor's location and telephone number are acknowledgments so long as they do not promote the sponsor's product or service. Additionally, the Treasury provides in this first group that value-neutral descriptions, displays, and visual depictions of a sponsor's product or service is an acknowledgment. The second group of illustrations describes advertisements as including messages that include qualitative or

comparative language, price information, calls to action, an endorsement, or an inducement to buy, rent, or sell.⁸⁷ Interestingly, the proposed regulation states that distribution of free samples of the sponsor's product at the sponsored event is not an inducement to buy, sell, or rent. Thus, apparently, such distribution is not advertising — at least for purposes of the ubit.

*E. Evidence of the Treasury's
Chameleon-like Qualities When it
Comes to Treating Sponsor-
Promotion by Charities as
Advertising*

Obviously, these definitions and descriptions by the Treasury in its proposed regulation represent a sharp departure from the Treasury's pre-1993 positions on the sponsorship issue. Prior to 1993, the Treasury's position was that a return benefit was substantial if the sponsorship arrangement amounted to a quid pro quo.⁸⁸ Thus, if the value of services rendered by the charity roughly equaled the value of the payment received, the entire sponsorship payment would likely be categorized as for advertising.⁸⁹

However, the Treasury has made an about-face in its 1993 proposed regulation. The proposed regulation permits several activities which in the past were classified as advertising to lose such classification. For example, the mere use of a non-promotional logo may be properly categorized as a mere acknowledgment. But there should rarely, if ever, be an occasion when a description, display, or depiction of a sponsor's product or service is non-promotional.⁹⁰ Additionally, it would be difficult to say, with a straight face, that a distribution of free samples of the sponsor's product at a charitable event is ever non-

promotional. In each of these cases, a sponsor would be engaging in the essence of advertising and promotion — getting its product to the customer so that the customer can try it. This is clearly a complete reversal by the Treasury of its pre-1993 position.

If there was any doubt about the Treasury's change in position, such doubt disappears once one analyzes Example 4 of the proposed regulation.⁹¹ Example 4 depicts a situation that is virtually identical to the situation involved in the Mobil Cotton Bowl TAM.⁹² In the Mobil Cotton Bowl TAM, the Treasury decisively ruled that such situations involving advertising at college bowl games satisfy the "trade or business" element of the § 1.513-1(a) three-pronged test. However, in Example 4, the same situation is classified as a mere acknowledgment and not an advertisement.

Many commentators have likewise noticed the Treasury's flip-flop.⁹³ For example, some have appropriately suggested that the Treasury has "capitulated" to charities⁹⁴ and is "giving away the store."⁹⁵ Others have observed that the proposed regulations "correct egregious errors in the proposed . . . guidelines."⁹⁶ Thus, regardless of the view one takes of the reason for, or the effect of, the Treasury's change in position, it is undisputed that its position has indeed changed.

F. Possible Rationales for the Service's Change of Heart Regarding Corporate Sponsorship

As is true with many government agency actions, one could posit endlessly as to why the Treasury did what it did in reversing its Mobil Cotton Bowl decision. The powers that be in the Treasury may have felt that this pre-1993 position was politically inexpedient. Indeed, at the time the proposed regulation was published

in early 1993, Congress was considering legislation that would have virtually invalidated the Treasury's proposed audit guideline position.⁹⁷ The stated purpose of the legislation was to "ensure that [the] proposed audit guidelines . . . are never finalized."⁹⁸ Congress' action is clearly a response to political pressure from the "charitable community." In fact, the sponsor of one piece of legislation that would codify the proposed regulation states:

Hundreds of tax-exempt organizations of all types — cultural, health, and sports — from around the country submitted comments opposing these guidelines out of fear that they would not be able to attract corporate funding for their exempt activities and that the benefit of the funds they do receive would be reduced.⁹⁹

Thus, the Treasury apparently issued the proposed regulation because Congress was going to do it anyway.

This is not the first time, and definitely not the last time, that the Treasury has initiated rule-making in anticipation of similar congressional action. Interestingly, § 513(c) — the statute under which the proposed regulation was promulgated — came about in the same manner. In 1967, the Treasury issued regulations regarding fragmentation just prior to Congress, in 1969, enacting legislation on the same matter.¹⁰⁰

IV. Conclusions About the Proposed Regulation

A. The Practical Effect of the Proposed Regulation

The most obvious effect of the proposed regulation, if finalized, is that charities receiving

sponsorship payments for charitable events will be subject to less scrutiny. In fact, reports indicate that both Treasury auditors and charities are already relying on the proposed regulation. For instance, the Treasury is reportedly refusing to impose the ubit on scoreboard advertising by corporate sponsors at various colleges and universities.¹⁰¹ This refusal is, apparently, due to the proposed regulation. Thus, the likelihood that the Treasury will ever impose the ubit on sponsorship payments is severely diminished by the proposed regulation.

Sponsors, taxable advertisers, and the Treasury itself may also feel the bite of this new position in the proposed regulation. Sponsors may now have an incentive to divert advertising dollars away from taxable advertisers, such as radio and television, and redirect these revenues toward tax-exempt advertisers. Absent special circumstances, the sponsor would likely reap the same tax benefits whether its sponsorship payment is classified as either a business expense or a charitable contribution deduction.¹⁰² However, due to its tax-exempt status, a charity could probably provide that advertising benefit to the sponsor for less money than a taxable entity could.¹⁰³ Thus, the sponsor benefits (and the Treasury loses) to the extent of the charity's tax savings. Additionally, the taxable advertiser loses to the extent of the lost potential after-tax profits on the sponsor's advertising business. This is the very problem that Congress sought to eliminate when it enacted the ubit.¹⁰⁴

B. The Legality of the Proposed Regulation

1. *A legal challenge to the proposed regulation would likely fail because it is not an*

impermissible exercise of the Treasury's rule-making power.

Aside from the practical effects of the proposed regulation, one should also consider the legality of the Treasury's regulatory action.¹⁰⁵ Specifically, even if the proposed regulation adversely affects a taxpayer, that taxpayer cannot have the proposed regulation invalidated in court without showing that the Treasury exceeded its legal bounds.¹⁰⁶ One obvious possibility is to show that the proposed regulation is an impermissible exercise of the Treasury's rule-making power.¹⁰⁷ As the following analysis demonstrates, this argument would likely fail.

2. The proposed regulation's definition of "advertising" is "permissible" under § 513.

Pursuant to § 7805(a), the Secretary of the Treasury is delegated general rule-making authority to "prescribe all needful rules and regulations" for the enforcement of the tax laws.¹⁰⁸ The Treasury promulgated the proposed regulation regarding sponsorship payments to charities pursuant to this congressional grant of general rule-making authority.¹⁰⁹ Although such interpretive regulations¹¹⁰ do not have the force and effect of law, they are generally subject to a very high standard of judicial review.¹¹¹ Thus, before a § 7805(a) interpretive regulation may be invalidated as a violation of regulatory authority, the reviewing court must make one of two findings:

- 1) That the regulation is inconsistent with Congress' clearly expressed statutory or legislative intent, or
- 2) If the statute or legislative intent is silent or ambiguous, that the regulation is not based on a permissible interpretation of the

statute.¹¹²

What is apparent from this judicial standard is that regulations — especially tax regulations — that interpret terms not already defined by statute or legislative history will likely be upheld as valid.¹¹³ Conversely, regulations that interpret terms that have already been defined by Congress — either in the statute or through legislative history — are less likely to survive judicial scrutiny.¹¹⁴ Thus, the absence, or presence, of a congressional definition of a term that an agency interprets and defines by regulation is often critical to deciding if the regulation is a valid exercise of rule-making power.

- a. *Chevron Case: An agency's interpretive regulations are entitled to "strong deference" by reviewing courts.*

The Supreme Court recently outlined this principle of "strong deference" to an agency's interpretation of a statute in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*¹¹⁵ *Chevron* involved the legality of a 1981 Environmental Protection Agency (EPA) regulation¹¹⁶ promulgated under a provision of the Clean Air Act Amendments of 1977 (CAAA).¹¹⁷ The CAAA provision required states not achieving certain air quality standards to establish stringent permit programs for regulation of new or modified major "stationary sources" of air pollution.¹¹⁸ The EPA regulation implementing this permit requirement allowed states to adopt a plant-wide definition of the term "stationary source."¹¹⁹ That is, the regulation allowed states to treat all pollution-emitting devices within the same plant as one "source."¹²⁰

Pursuant to a judicial challenge, the United

States Court of Appeals for the District of Columbia set aside the EPA regulation as "inappropriate" considering the CAAA's purpose of improving air quality.¹²¹ The Supreme Court reversed the Court of Appeals' ruling.¹²² Noting that the EPA regulation was based on a "permissible" construction of the CAAA, the Court differed with the appellate court as to the appropriate standard of review for EPA's regulatory action.¹²³ The Court held that, where Congress has not expressly or implicitly addressed a statutory issue, an agency's rule addressing that issue will be upheld if it is a permissible interpretation of the statute.¹²⁴ The permit program's purpose was to "accommodate the conflict between the economic interest in permitting capital programs and the environmental interest in improving air quality."¹²⁵ Recognizing that Congress failed to accommodate these interests on the level of specificity presented in the *Chevron* case, the Court concluded that EPA's reasonable accommodation would be upheld.¹²⁶

- b. *National Muffler Case: An agency's interpretive regulation will be upheld by a reviewing court if it reasonably implements a congressional mandate.*

The defining case in which the Supreme Court outlined appropriate standards by which to judge the Treasury's rule-making power under § 7805 is *National Muffler Dealers Ass'n, Inc. v. United States*.¹²⁷ *National Muffler* involved the legality of a treasury regulation that defined the term "business league" as used in § 501(c)(6) of the Code. The taxpayer in *National Muffler* was an association of franchisees for Midas Muffler Company. The association sued the government

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in federal district court for refund of previously paid federal income taxes on the ground that it was improperly denied tax-exempt status as a § 501(c)(6) "business league."¹²⁸

The district court denied the association's refund request, concluding that the Midas franchisees do not constitute a "line of business" under Treasury Regulation § 1.501(c)(6)-1.¹²⁹ The court of appeals, noting the absence of direct statutory guidance, affirmed the district court ruling. The court reasoned that the Treasury's line of business requirement is consistent with the congressional intention that the exemption apply to "organizations which promote some aspect of the general economic welfare rather than support particular private interests."¹³⁰

On review by writ of certiorari, the Supreme Court affirmed the appellate court's conclusion that Treasury Regulation § 1.501(c)(6)-1 was valid. The Court stated that, because the term "business league" has "no well-defined meaning or common usage" outside of tax law, it is the type of term that most appropriately lends itself to interpretive regulation. Under such circumstances, "if [the regulation] is found to implement the congressional mandate in some reasonable manner," it must be upheld.¹³¹ One element of the congressional mandate supporting the "business league" exemption was to exempt organizations primarily purposed to promote general business welfare.¹³² According to the Court, the Treasury's conclusion that business leagues should work towards "improvement of business conditions of one or more lines of business" is consistent with congressional intention.

c. Application of Chevron

and National Muffler to the corporate sponsorship regulations

With regard to corporate sponsorship payments, the proposed regulation represents the Treasury's interpretation of what Congress means in § 513 by the term "trade or business" and, more specifically, "advertising" trade or business. Although it has often referred to advertising as being a primary object of the unit, Congress has never defined the term "advertising" for purposes of § 513. Additionally, until issuance of the proposed regulation in 1993,¹³³ the regulations issued under the statutes imposing the unit (i.e., §§ 511-514) did not define "advertising." Finally, § 513 is a federal taxing statute that the Treasury is charged with administering. Accordingly, pursuant to *Chevron* and *National Muffler*, the Treasury is given wide latitude to, based upon its technical and policy expertise, interpret "advertising" in any permissible manner.¹³⁴

Presumably, a "permissible" and "plausible" interpretation of "advertising" as a § 513 trade or business would include a range of possibilities. For instance, one might conceive of a definition of advertising that covers even the slightest promotion or preference of a donor's product or service. Accordingly, under this conservative approach, any donation to a charitable event which is recognized publicly by the tax-exempt recipient (or anyone else), would be for an advertising benefit.¹³⁵ At the other extreme, one might imagine a situation in which only the most egregious cases of promotion would be classified as advertising. Such a case might occur if the sponsor required, by contract and as a condition of sponsorship, that the tax-exempt recipient air a 30-minute television commercial espousing the virtues of the

sponsor's product or service.¹³⁶

Admittedly, each of these definitions of advertising is extreme and very unlikely to emerge in any final version of the proposed regulation. However, each of these definitions is "plausible" in that neither of them contradicts Congress' expressed desires regarding the ubit to tax trade or business income. Furthermore, the ubit regulatory scheme, as is true of most taxing schemes, is technical and complex.¹³⁷ Thus, so long as the Treasury (in its final regulations) considers advertising as a "trade or business" in a "detailed and reasoned fashion" and chooses a definition that reconciles "conflicting policies,"¹³⁸ its determination will be upheld under almost any scenario.

3. *The Treasury's change in position as to the definition of "advertising" does not invalidate the current definition.*

As is apparent from this article, the proposed regulation represents a change by the Treasury of its position on what is, and what is not, a "trade or business" for ubit purposes. One might argue that a final regulation that represents such a "sharp" break from the past should not receive as much deference as is ordinarily warranted under *Chevron* and *National Muffler*. Arguably, a policy that has been in existence for a matter of months may not be as sound as one that has been tested for several years. Nonetheless, the Supreme Court has held that such changes do not result in less deference.

In *Rust v. Sullivan*,¹³⁹ the Court, rejecting the petitioner's argument, held that an agency's interpretation of a statute is entitled to *Chevron*-type deference despite its "sharp break" with prior interpretations.¹⁴⁰ Furthermore, the *Chevron* Court, which also addressed this

changing interpretation issue, implied that such changes are a necessary part of agency administration:

The fact that the agency has from time to time changed its interpretation of the term "source" does not, as respondents argue, lead us to conclude that no deference should be accorded the agency's interpretation of the statute. An initial agency interpretation is not instantly carved in stone. On the contrary, the agency, to engage in informed rule-making, must consider varying interpretations and the wisdom of its policy on a continuing basis.¹⁴¹

Finally, the Court in *National Muffler* faced this same issue of the effect of a "regulatory shift."¹⁴² The Court there rejected the notion that the change necessarily results in invalidity of the interpretation. Justice Blackmun wrote "[w]e would be reluctant to adopt the rigid view that an agency may not alter its interpretation in light of administrative experience." Thus, even though narrowing the definition of "advertising" to exclude some traditional advertising activities represents a change in the Treasury's position, this change does not eliminate the deference due under *Chevron* and *National Muffler*.¹⁴³

V. **What Should the Treasury Do?**

Even though the proposed regulation may be legal, the Treasury should nevertheless revert back to its pre-1993 position regarding its treatment of corporate sponsorship payments. Under this earlier position, if the sponsorship arrangement was motivated by profit or was akin to a "quid pro quo," the Treasury would rule that

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the trade or business element of the § 1.513-1(a) three-pronged test was satisfied. However, if the benefit to the sponsor was no more than a mere recognition of the contribution, then no ubit would apply.

On the surface, it appears as if this type of anticipatory rule-making by the Treasury is contrary to an executive agency's non-legislative role of executing, not writing, the law.¹⁴⁴ However, as the *Chevron* and *National Muffler* analyses indicate, this type of agency action by the Treasury does not result in improper rule-making. On the other hand, avoiding illegality should not be the only guide for an executive agency. An agency's regulations should reflect the reasonable expectations of those affected by them. Proposed Treasury Regulation § 1.513-4 fails to reflect such reasonable expectations.

One would reasonably expect that an arrangement primarily motivated by profit, rather than charitable objectives, is a business arrangement for both parties.¹⁴⁵ Accordingly, such business arrangements should be taxable for ubit purposes. However, the proposed regulation excludes from the term "advertising" (i.e., one type of trade or business) arrangements that are, without a doubt, both promotional and business-like. In particular, Example 4 (involving the Mobil Cotton Bowl sponsorship arrangement) of the proposed regulation eliminates any chance that proceeds from a bowl game sponsor will ever be unrelated business taxable income.

Admittedly, charities such as bowl game organizers need money to survive. But one must not lose sight of the fact that these games are, allegedly, charitable events. As such, and in keeping with ubit policy of not subsidizing primarily commercial ventures, the Treasury should ensure that even charities pay their fair

share of taxes. This article suggests that, although the proposed regulation would not be invalidated in a court challenge as an improper exercise of regulatory authority, significant advertising dollars will be diverted from taxable entities to non-taxable entities as a result of its promulgation. Furthermore, this diversion of revenues occurs solely due to the non-taxable entity's tax-exempt status. Accordingly, the Treasury is creating the very situation that the ubit should seek to avoid — unfair commercial competition.

Notes

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1. This article will often refer to the Treasury Department, even where the more appropriate reference would be to the Internal Revenue Service. This article will also refer to various sections of the Internal Revenue Code of 1986 (26 U.S.C.) simply by their section numbers for the sake of brevity.

2. Prop. Treas. Reg. §1.513-4, 58 Fed. Reg. 5690 (1993).

3. See § 513(a) (1994); see also Tax Reform Act of 1969 at 1313, Pub. L. No. 91-172, 83 Stat. 487 (1969).

4. The proposed regulation attempts to distinguish corporate sponsorship arrangements which constitute mere acknowledgments from those that represent payments for advertising. The phrase "mere acknowledgment" is not defined in the proposed regulation. Instead, several examples of acknowledgments are given. See Prop. Treas. Reg. §

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1.513-4, 58 Fed. Reg. 5690 (1993).

5. Prop. Treas. Reg. § 1.513-4(c), 58 Fed. Reg. 5690 (1993).

6. Prop. Treas. Reg. § 1.513-4(c)(1), 58 Fed. Reg. 5690 (1993).

7. Prop. Treas. Reg. § 1.513-4(c)(2), 58 Fed. Reg. 5690 (1993).

8. Although this article is primarily concerned with the effect of classification of a sponsorship payment on the charity/payee, the effect on the sponsor/payor should not be ignored. If a sponsorship payment is treated as advertising from the payor's perspective, then the payor may be entitled to a § 162 business expense deduction. On the other hand, if the payment is treated as an acknowledgment from the payor's perspective, then the payor may be entitled to a § 170 charitable contribution deduction. However, this does not necessarily mean that the payor is indifferent as to the treatment of the payment as has been suggested by at least one author. See Frank James Vari, *The Unrelated Business Income Tax and Its Effects Upon Collegiate Athletics*, 9 AKRON TAX J. 111 (1992). For example, the Treasury may deny a payor's business expense deduction as unreasonable and/or excessive. Also, a charitable contribution deduction may be denied, in whole or in part, if the payor's 170 contribution base is not sufficient to support a full deduction. Thus, the payor may be very concerned with the treatment of the sponsorship payment as either a payment for advertising or acknowledgment benefit.

9. See part III, F *infra*.

10. See Nathan Wirtschafter, *Fourth Quarter Choke: How the IRS Blew the Corporate Sponsorship Games*, 27 LOYOLA OF L.A. L. REV. 1465 (1994), for a more exhaustive look at the policy concerns raised by the Treasury's issuance of the proposed regulation.

11. The assumption is that, if the tax-exempt organization was engaged in an advertising trade or business, allowed deductions would be less than adjusted gross income for unit liability calculation purposes.

12. Paul Streckfus, *News Analysis: IRS Pre-Inaugural Gift For Charities*, 58 TAX NOTES 384 (Jan. 25, 1993).

13. The Sixteenth Amendment granted Congress "power to lay and collect taxes on incomes, from whatever source derived . . ." U.S. Const. amend. XVI.

14. See generally §§ 501-528 (subchapter F, chapter 1, subtitle A) (1994). See also Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L.REV. 501 (1990), for a discussion of the various rationales for granting tax-exemption to entities and organizations described in § 501(c)(3) — often called "public benefit organizations"; Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 95-96 (1981), for a discussion of rationales for granting tax-exemption to tax-exempt organizations not described in § 501(c)(3). These non-501(c)(3) organizations are commonly referred to as mutual benefit organizations because their income is generally used for the mutual benefit of individual members.

15. See 26 U.S.C. § 170(c) (1994). But note, the entities to which tax deductible charitable contributions may be made are not explicitly referred to in § 170(c) as "tax-exempt" entities. However, the descriptions of these entities are virtually identical to the descriptions of entities described elsewhere in the Code as being exempt from federal income taxation. See generally, 26 U.S.C. § 501(c) (1994). For example, the charitable entities described in § 170(c)(2) are almost exactly the same as those described in § 501(c)(3). Additionally, the cemetery companies described in § 170(c)(5) are very similar to those described in § 501(c)(13). Thus, although not explicitly stated, the structure of § 170(c) has the effect of requiring that the entities to whom charitable contributions are made be tax-exempt.

16. 26 U.S.C. § 501(c)(3) (1994). Because they receive this double benefit of both a tax exemption and the right to receive tax-deductible contributions, § 501(c)(3) organizations have historically been subject to greater scrutiny than other charities. Accordingly, if a § 501(c)(3) organization has too much bad (i.e., unrelated) income, it is in danger of losing its highly regarded § 501(c)(3) status.

17. See *Revenue Act of 1950: Hearing Before House Ways and Means Committee*, Vol I, 81st Cong., 2d Sess. 19 (1950). The House Ways and Means Committee report on the Revenue Act of 1950 states:

The problem at which the tax on unrelated business income is directed here is primarily that of unfair competition. The tax-free status

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of . . . [charities] enables them to use their profits tax-free to expand operations, while their competitors can expand only with profits remaining after taxes. Also, a number of examples have arisen where these organizations have, in effect, used their tax exemption to buy an ordinary business. That is, they have acquired the business with no investment on their own part and paid for it in installments out of subsequent earnings — a procedure which usually could not be followed if the business were taxable.

H. R. REP. NO. 2319, 81st Cong., 2d Sess., at 36-37.

18. See *C.F. Mueller Co. v. Commissioner*, 190 F.2d 120 (3d Cir. 1951). The Third Circuit in *Mueller* held that the acquiring corporation maintained its tax-exempt status regardless of its method of obtaining funds.

19. See *Trinidad v. Sagrada Orden de Predicadores*, 263 U.S. 578 (1924), in which the Supreme Court first announced the "destination of income" doctrine. In *Trinidad*, a religious organization's exempt status was upheld even though it engaged in significant non-religious activities (real estate investments, stock investments, food sales, etc.) because of the Court's recognition that "such religious activities cannot be carried on without money."

20. 26 U.S.C. § 511(a) & (b) (1994). See also 26 U.S.C. § 512(b) and 513(a)(1-3) & (d-h) for exceptions to this general rule.

21. See MICHAEL I. SANDERS, *PARTNERSHIPS & JOINT VENTURES INVOLVING TAX-EXEMPT ORGANIZATIONS* (John Wiley & Sons, 1994), for a discussion of current practical issues involving the unit. This book has been described as "an informative and thorough guide to alternative means of furthering an organization's charitable purposes." See Marlis Carson, *Guidance For Exempt Organization Practitioners: The Latest on Partnerships and Joint Ventures*, 63 TAX NOTES 775 (May 9, 1994).

22. § 511(a) & (b) provide:

(a)(1) Imposition of Tax

There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a tax computed as provided in section 11. In making such

computation for purposes of this section, the term "taxable income" as used in section 11 shall be read as "unrelated business taxable income."

(2) Organizations Subject to Tax

The tax imposed by paragraph (1) shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in section 501(c)(1)) which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a). The tax imposed by paragraph (1) shall apply in the case of any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof, or by any agency or instrumentality of one or more governments or political subdivisions. Such tax shall also apply in the case of any corporation wholly owned by one or more such colleges or universities

(b) (1) Imposition of Tax

There is hereby imposed for each taxable year on the unrelated business taxable income of every trust described in paragraph (2) a tax computed as provided in section 1(e). In making such computation for purposes of this section, the term "taxable income" as used in section 1 shall be read as "unrelated business taxable income" as defined in section 512.

(2) Charitable, etc., Trusts Subject to Tax

The tax imposed by paragraph (1) shall apply in the case of any trust which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a) and which, if it were not for such exemption, would be subject to subchapter J (sec. 641 and following, relating to estates, trusts, beneficiaries, and decedents).

23. 26 U.S.C. § 512(a)(1) (1994) provides:

For purposes of this title, [e]xcept as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in

section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Certain traditionally passive income items (e.g., § 512(b)(1) dividends and interest; § 512(b)(2) royalties) and § 512(b)(3) rent are excluded from the definition of unrelated business taxable income.

24. 26 U.S.C. § 513(a) (1994) provides:

The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or performance of any purpose or function described in section 501(c)(3)), except that such term does not include any trade or business —

(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or
(2) which is carried on, in the case of an organization described in section 501 (c)(3) or in the case of a college or university described in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees, or, in the case of a local association of employees described in section 501(c)(4) organized before May 27, 1969, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

25. See Prop. Treas. Reg. §1.513-1(a), 58 Fed. Reg. 5690 (1993), which provides, in part, that, unless a specific exception of §§ 512 or 513 applies, gross income of a covered tax exempt entity is includible in the computation of unrelated business taxable income if all three elements of this test are met.

26. See 26 U.S.C. § 513(a)(1-3) (1994), which excludes from the term "trade or business" any trade or business (1) in which substantially all of the work in carrying on the trade or business is done for free; (2) which is carried on primarily for the benefit of its members, students, patients, officers, or employees; or (3) which is, substantially, the selling of contributed or gift property. Other exceptions are provided for certain trade shows and state fairs, certain hospital services, bingo games, pole rentals, and distributions of low cost articles. See generally 26 U.S.C. § 513(d)-(h) (1994).

27. See 26 U.S.C. § 512(b) (1994). See also *infra*, note 24.

28. The term "taxable income" is a term of art in tax law. It is defined in the Internal Revenue Code, generally, as gross income minus certain allowed deductions. 26 U.S.C. § 63(a) (1994). Taxable income is the dollar amount to which the appropriate tax rate is applied.

29. See Prop. Treas. Reg. §1.513-1(b), 58 Fed. Reg. 5690 (1993), which provides, in part:

The primary objective of adoption of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete. On the other hand, where an activity does not possess the characteristics of a trade or business within the meaning of section 162, such as when an organization send out low cost articles incidental to the solicitation of charitable contribution, the unrelated business income tax does not apply since the organization is not in competition with taxable organizations. However, in general, any activity of a section 511 organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute "trade or business" within the meaning of section 162 — and which, in

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addition, is not substantially related to the performance of exempt functions — presents sufficient likelihood of unfair competition to be within the policy of the tax. Accordingly, for purposes of section 513 the term “trade or business” has the same meaning it has in section 162, and generally includes any activity carried on for production of income from the sale of goods or performance of services . . .

30. See *U.S. v. American Bar Endowment*, 477 U.S. 105, 110 (1986). See also *Commissioner v. Groetzinger*, 480 U.S. 23 (1987), where the Court held that a full-time gambler who regularly made bets solely for his own account was engaged in a § 162 trade or business because the primary purpose for engaging in the gambling activity was for income or profit. Accord *West Virginia State Medical Association v. Commissioner*, 91 T.C. 651 (1988), *aff’d*, 882 F.2d 123 (4th Cir. 1989), *cert. den.*, 110 S. Ct. 839 (1990).
31. See 26 U.S.C. § 513(h) (1994), where Congress has provided for a specific exemption from unit for income generated by the distribution of so-called low cost articles.
32. See Prop. Treas. Reg. § 1.513-1(c)(1), 58 Fed. Reg. 5690 (1993), which provides, in part:

In determining whether trade or business from which a particular amount of gross income derives is “regularly carried on,” within the meaning of section 512, regard must be had to the frequency and continuity with which the activities productive of income are conducted and the manner in which they are pursued. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the nonexempt business endeavors with which they compete. Hence, for example, specific business activities of an exempt organization will ordinarily be deemed to be “regularly carried on” if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

33. See *National Collegiate Athletic Ass’n v. Commissioner*, 914 F.2d 1417 (10th Cir. 1990).
34. See Prop. Treas. Reg. § 1.513-1(c)(2)(ii), 58

Fed. Reg. 5690 (1993).

35. Because this regularly carried on prong of the test relies on potential, and not actual, competition, this article rejects the notion that a short period of competition with major taxable advertisers can be ignored. *But see* *National Collegiate Athletic Ass’n*, 914 F.2d at 1425.

36. See Prop. Treas. Reg. § 1.513-1(d)(1), 58 Fed. Reg. 5690 (1993), which provides:

Gross income derives from “unrelated trade or business,” within the meaning of section 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question — the activities, that is, of producing or distributing the goods or performing the services involved — and the accomplishment of the organization’s exempt purposes.

37. See generally Prop. Treas. Reg. § 1.513-1(d)(2), 58 Fed. Reg. 5690 (1993), which provides, in part:

Trade or business is “related” to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is “substantially related,” for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

38. It is unclear from the legislative history whether the concern addressed by § 513(c) was whether the activity was a business or whether it was exempt. However, the concern of the Tax Reform Act of 1969 was to eliminate the perception of "unfairness" in the tax laws. INTERNAL REVENUE ACTS, 1966-1970. Accordingly, the concern that § 513(c) was directed at was probably whether portions of overall exempt activities could be taxed as though they were conducted separately.

39. The House Report to the Tax Reform Act of 1969 provides:

Under this provision, it is anticipated that advertising income from publications (whether or not the publications are related to the exempt purpose of the organization) will constitute unrelated business income to the extent it exceeds expenses related to the advertising, and, if the editorial aspects of publication are carried on at a loss, to the extent it exceeds this loss. . . .

Where an unrelated business activity, such as the sale of advertising in a publication of a tax-exempt organization, or other commercial exploitation of the exempt function . . . , the Secretary or his delegate is to prescribe regulations respecting the allocation of income and expenses and other deductions which are attributable to the unrelated activity so as to clearly reflect unrelated business taxable income from such activity, and to prevent avoidance of unrelated business income tax liability.

H.R. REP. NO. 91-413, pt. 1, 50 (1969), *reprinted in* INTERNAL REVENUE ACTS, 1966-1970, *supra* note 39, 1343-44.

40. It is assumed throughout this article that advertising is always a trade or business, whether it is done on a daily, weekly, monthly, or annual basis. At least one commentator suggests that the assumption that, for unit purposes, advertising is always a "trade or business" applies only to advertising in daily, weekly, or monthly journals. As regards advertisements in programs for annual charitable events, the commentator suggests a facts and circumstances approach to determining if a "trade or business" for unit purposes exists. *See* Elizabeth

Magin, *Advertising, the Unrelated Business Income Tax, and National Collegiate Athletic Association v. Commissioner*, 7 EXEMPT ORGS. TAX REV. 209 (Feb. 1993).

41. This article often refers to charities as being "favored" in the sense that they generate income without incurring a corresponding income tax obligation. However, charities are also favored, in many instances, by not having to pay sales or property taxes on goods or property purchased to conduct the business or sold by the business. But note, some states, such as Florida, limit the use of these sales and property tax benefits to only some of the § 501(c) charities. FLA. STAT. ch. 212.08(7)(o)2a-d (Supp. 1996).

42. 26 U.S.C. § 513(c) provides:

For purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

43. 26 U.S.C. § 513(c) is a codification of Treas. Reg. § 1.513-1(b), promulgated on December 12, 1967 and cited by Congress as the reason for enactment of § 513(c). H.R. REP. NO. 91-413, pt. 1, at 50.

44. The term "related" refers to activities that are related to the purpose for which the entity was granted its tax exemption. *See* H.R. REP. NO. 91-413 at 46.

45. *See* Treas. Reg. § 1.513-1(b) & (d)(3).

46. *See* National Collegiate Athletic Ass'n v. Commissioner, 914 F.2d 1417, 1420 (10th Cir. 1990) (recognizing that program advertising for sponsors of the Final Four Basketball Tournament is a trade or business activity but is not subject to tax because the activity is not regularly carried on).

47. H.R. REP. NO. 91-413, pt. 1, at 50.

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48. In § 1.513-1(b) the Treasury gives an example of a pharmacy in a hospital selling prescription drugs to both the general public and to the hospital's patients. The fact that all of the drugs are sold in one overall pharmacy business does not prevent the Treasury from fragmenting the pharmacy into two businesses — one selling to the public and one selling to patients. Since selling to patients is exempt under § 513(a), then only the sales to the general public generate trade or business income that is potentially subject to the ubit.

49. James McGovern, *Service's McGovern Explains Proposed Corporate Sponsorship Regulations*, 58 TAX NOTES 795 (Feb. 8, 1993). The annualized growth rate and the \$3 billion figure were derived from information provided by the Internal Revenue Service through its associate chief counsel, James McGovern, on February 3, 1993, to the ABA Taxation Section. The actual figures given were that payments to sponsored events have "grown from \$400 million in 1984 to \$3 billion in recent years."

50. See generally Tech. Adv. Mem. 91-47-007, 9147007 WL, at *4 (Aug. 16, 1991).

51. 26 U.S.C. § 501(a) (1994).

52. 26 U.S.C. § 511(a) (1994).

53. Tech. Adv. Mem. 91-47-007, 9147007 WL, at *8 (Aug. 16, 1991).

54. 26 U.S.C. § 6110(j)(3) (1994).

55. It is widely believed that the two bowl games involved in Tech. Adv. Mem. 91-47-007 were the "Mobil Cotton Bowl" and the "John Hancock Bowl." See David A. Haimes, *Corporate Sponsorships of Charity Events and the Unrelated Business Income Tax: Will Congress or the Courts Block the IRS Rush to Sack the College Football Bowl Games?*, 67 NOTRE DAME L. REV. 1079 n.1 (1992). Thus, for easy reference, this article will refer to Tech. Adv. Mem. 91-47-007 as the "Mobil Cotton Bowl TAM."

56. Although the exact amount of the sponsorship fee is unknown, the contract reportedly provided that the fee would be increased if the event received a Nielsen television rating above a certain level. Paul Streckfus, *A Glimpse of Mobil-Cotton Bowl Contract Provisions*, 55 TAX NOTES 447 (April 27, 1992).

57. *Id.*

58. In the context of defining a "contribution or gift" for purposes of the § 170 charitable contribution deduction, the Treasury has ruled that if the return benefit is insubstantial the deduction will be allowed.

Thus, where the only return benefit to a contributor is the privilege of being associated with, or being known as a benefactor of, a tax exempt entity, the benefit is insubstantial. See Rev. Rul. 68-432, 1968-2 C.B. 104. Otherwise, the Treasury's position is that it will be presumed not to be a contribution or gift. See Tech. Adv. Mem. 91-47-007, 9147007 WL, at *7. Similarly, in the context of deciding whether a tax exempt-entity has exploited its exempt purpose, the Treasury has ruled that a simple statement that a charitable event has been paid for by the sponsor is not exploitative. See Rev. Rul. 67-342, 1967-2 C.B. 187, 188; Rev. Rul. 77-367, 1977-2 C.B. 193, 194. 59. See *Hernandez v. Commissioner*, 490 U.S. 680, 690 (1989).

60. This article assumes this to be the Treasury's rationale for finding a lack of substantial relationship. The actual language of the TAM that addresses this issue provides:

The Organization's activities are not substantially related to its exempt function. Neither the addition of the . . . nor the displaying of . . . contributes importantly to the Organization's educational purpose.

Tech. Adv. Mem. 91-47-007, 9147007 WL, at *6-7.

61. Presumably, the "significant period of time" referred to by the Treasury here refers to a period of at least three months. See Rev. Rul. 73-424, 1973-2 C.B. 190, 191, cited in Tech. Adv. Mem. 91-47-007, 9147007 WL, at *4 (ruling that three months of advertising solicitation was "extensive" and "typical of commercial endeavors.")

62. See *National Collegiate Athletic Ass'n v. Commissioner*, 914 F.2d at 1422 (stating that the Treasury argued that both time spent soliciting and preparing program advertisements and time during which the programs are distributed should count in determining "regularly carried on").

63. True, the CBAA's arguments against the trade or business element and the unrelated element were not totally baseless. Nevertheless, the Treasury's rejection of these arguments was consistent with the Supreme Court's earlier decisions in this area. See generally *United States v. American Bar Endowment*, 477 U.S. 105, 118 (1986); *United States v. American College of Physicians*, 475 U.S. 834 (1985). See also *Domenique Comach, NCAA v.*

Commissioner of I.R.S.: When will the Internal Revenue Service Consider an Activity Regularly Carried On?, 19 J.C. & U.L. 39, 41-42 (1992) (discussing generally how the term "regularly carried on" is used in the context of university advertising).

64. National Collegiate Athletic Ass'n, 914 F.2d at 1417.

65. *Id.* at 1422; Rev. Rul. 73-424, 1973-2 C.B. 190.

66. National Collegiate Athletic Ass'n, 914 F.2d at 1424.

67. *See e.g.*, Prop. Treas. Reg. § 1.513-1(c)(1).

68. *See* Rev. Rul. 73-424, 1973-2 C.B. 190.

69. *See* I.R.S. Announcement 92-15, 1992-5 I.R.B.

51.

70. *Id.*

71. Haimes, *supra* note 55, 1079 n.1.

72. I.R.S. Announcement 92-15, § 178.1(1).

73. I.R.S. Announcement 92-15, § 178.1(3).

74. I.R.S. Announcement 92-15, § 178.2.

75. I.R.S. Announcement 92-15, § 178.3.

76. I.R.S. Announcement 92-15, § 178.3(3).

77. I.R.S. Announcement 92-15, § 178.3(2).

78. I.R.S. Announcement 92-15, § 178.3(3)(a).

79. The commentator suggests as follows:

The IRS should revise the substantial return benefit factors to concentrate solely on the exempt organization and the actual services the exempt organization provided to the corporate sponsor. The IRS should include only the first and fourth factors in the final guidelines: "the value of the service provided [by the exempt organization] in exchange for the payment" and "whether the extent of the [exempt] organization's exposure of the donor's name constitutes significant promotion." When evaluating these factors, the IRS should concentrate only on the services the exempt organization provided.

David A. Haimes, *supra* note 55, 1104-05.

80. 477 U.S. at 109-16.

81. A focus on the "expectations" of the sponsor/contributor is also consistent with gift analysis for income tax purposes. *See* Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278 (1960) (holding that the most critical factor in determining whether a payment was a gift is the intentions (i.e., expectations) of the donor (i.e.,

sponsor)).

82. *See generally* Prop. Treas. Reg. § 1.513-4, 58 Fed. Reg. 5690 (1990).

83. Proposed Treasury Regulation § 1.513-4 states that it does not apply to advertising in exempt organization periodicals. "Periodicals" is defined as including regularly scheduled and printed material that is both unrelated to a charitable event and not distributed in connection with such event. Prop. Treas. Reg. § 1.513-4(a), 58 Fed. Reg. 5690 (1993). *See also* Prop. Treas. Reg. § 1.512(a)-1(f), 58 Fed. Reg. 5687 (1993) for advertising in exempt organization periodicals.

84. Prop. Treas. Reg. § 1.513-4(b), 58 Fed. Reg. 5690 (1993). Notably, this definition of advertising is consistent with the basic notion that advertising includes any form, or type, of promotion or marketing in exchange for payment.

85. Prop. Treas. Reg. § 1.513-4(c)(1), 58 Fed. Reg. 5690 (1993).

86. Prop. Treas. Reg. § 1.513-4(g), 58 Fed. Reg. 5690 (1993). Thus, under the proposed regulation, a naming gift alone — such as would have been the case if Mobil simply gave the sponsorship payment to the CBAA on the condition that the Cotton Bowl be re-named the Mobil Cotton Bowl — will continue to be classified as an acknowledgment.

87. *Id.*

88. *See generally* Tech. Adv. Mem. 91-47-007, 9147007 WL (Aug. 16, 1991).

89. *Id.* *See also*, I.R.S. Announcement 92-15, § 178.1.

90. *But see* Prop. Treas. Reg. § 1.513-4(g) ex. 3, 58 Fed. Reg. 5690 (1993), which provides as follows:

O organizes sports tournaments for local charities across the country that are underwritten by an auto manufacturer. O acknowledges the sponsored payment by including the manufacturer's name and logo in the title of the tournament and displaying the manufacturer's name and logo on signs, scoreboards and other printed material. The auto manufacturer receives complimentary admission passes and pro-am playing spots. Additionally, O displays the latest models of the sponsor's premier luxury cars in the tournament area. O's activities are acknowledgments of the payment and not

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advertising

91. See Prop. Treas. Reg. §1.513-4(g) ex. 4, 58 Fed. Reg. 5690 (1993), which provides as follows:

P conducts an annual college football bowl game. P sells to commercial broadcasters the right to broadcast the bowl game on television and radio. A major corporation agrees to be the exclusive sponsor of the bowl game. The sponsorship payment includes amounts to be paid to the colleges participating in the bowl game. The detailed contract between P and the corporation provides that the name of the bowl game will include the name of the corporation. The contract further provides that the corporation's name and a special logo will appear on players' helmets and uniforms, on the scoreboard and stadium signs, on the playing field, on cups used to serve drinks at the game, and on all related printed material distributed in connection with the game. The sponsorship agreement is contingent upon the game being broadcast on television and radio, but the amount of the sponsorship payment is not contingent upon the number of people attending the game or the television ratings. The contract provides that television cameras will focus on the corporation's name and logo on the field at certain intervals during the game. P's activities are acknowledgments of the payments and not advertising

92. See generally Tech. Adv. Mem. 91-47-007, 9147007 WL (Aug. 16, 1991). Some of the differences between the situations in the Mobil Cotton Bowl TAM and Example 4 are as follows:

- (1) the amount of the sponsorship payment by Mobil, but not by P, was contingent on the event receiving a specified rating,
- (2) the actual payment itself was voidable by Mobil, but not by P, if the event was not televised, and
- (3) a portion of the payment by P, but not by Mobil, was to be paid directly to the colleges participating in the event.

93. See generally, Paul Streckfus, *supra* note 13; James McGovern, *Service's McGovern Explains Proposed Corporate Sponsorship Regulations*, 58 TAX NOTES 795 (Feb. 8, 1993); Milton Cerny, *Letter*

to the Editor: Sponsorship Regs Deserve Cheers, Not Boos, 61 TAX NOTES 125 (Oct. 4, 1993).

94. One commentator said the following:

The IRS, perhaps a bit disingenuously, began a January 19 News Release (IR-93-3) with this statement: "The Internal Revenue Service said regulations it proposed today give clear guidance to tax exempt organizations such as college football bowls, museums and symphonies on the tax treatment of corporate sponsorship payments they receive." A more to-the-point opening might have been: "The IRS today capitulated to college football bowls, museums and symphonies and will rarely, if ever, tax them on advertising payments they receive as part of a corporate sponsorship arrangement." (emphasis in original).

Paul Streckfus, *supra* note 12, at 384.

95. James McGovern, *supra* note 93, at 796 (discussing an earlier Tax Notes article entitled "The Goldberg Variations, or Giving Away the Store").

96. Milton Cerny, *supra* note 94, at 125.

97. See, e.g., S. 1171, 103d Cong., 1st Sess. (1993), which, in part, provides:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. Exclusion From Unrelated Business Income For Certain Sponsorship Payments.

In General. — Section 513 of the Internal Revenue Code of 1986 (Relating to unrelated business taxable income) is amended by adding at the end thereof the following new subsection:

TREATMENT OF CERTAIN SPONSORSHIP PAYMENTS. —

(1) In General. — The term 'unrelated trade or business' does not include the activity of soliciting and receiving qualified sponsorship payments with respect to any qualified public event.

(2) Qualified Sponsorship Payments. — For purposes of this subsection, the term 'qualified sponsorship payment' means any payment by any person engaged in a trade or business with respect to which there is no arrangement or

- expectation that such person will receive any substantial return benefit other than —
- (A) The use of the name or logo of such person's trade or business in connection with any qualified public event under arrangements (including advertising) in connection with such event which acknowledge such person's sponsorship or promote such person's products or services, or
- (B) The furnishing of facilities, services, or other privileges in connection with such event to individuals designated by such person.
98. 139 CONG. REC. S 8234 (daily ed. June 22, 1993) (statement of Sen. Breaux). *See also* 139 CONG. REC. E 1010 (daily ed. April 22, 1993) (statement by Rep. Brewster) for similar comments regarding the House companion bill to S. 1171 (H.R. 1551, 103d Cong., 1st Sess (1993)).
99. 139 CONG. REC. S 8234, 8235.
100. *See infra* note 43.
101. *See* Paul Streckfus, *News Analysis: Are Universities Winning the Battle Against UBIT?*, 62 TAX NOTES 953 (Feb. 21, 1994), stating the following:
- Colleges and universities had been concerned that scoreboard advertising, whether in fieldhouses or stadiums, would be subject to the unrelated business income tax. However, the IRS apparently is now accepting one or more of the following arguments for a 'no tax' result: that any scoreboard advertising qualifies under the proposed corporate sponsorship regulations; that any advertising escapes UBIT because it is not regularly carried on (for example, the IRS reportedly accepted this argument to exempt scoreboard advertising in a college football stadium because there were only five home games); that the advertising payments qualify as royalties; or that the advertising payments qualify as rental payments. Most colleges are making all of these arguments, and recent reports indicate the IRS is conceding the advertising issue on audit.
102. For illustrative purposes, this article ignores additional intangible benefits to the sponsor of being viewed by potential customers as a "good" company for contributing to a charity.
103. If all variables are equal for a given advertising

arena, a tax-exempt advertiser could, to the extent of any foregone income tax, provide service to a sponsor at a lower rate than a taxable advertiser.

104. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (1969).

105. For additional discussion of the limitations on the Treasury's legal authority to do what it does by way of regulation and revenue ruling, see generally, Charles J. Cooper, et al., *The Legal Authority of the Department of the Treasury to Promulgate a Regulation Providing for Indexation of Capital Gains*, 12 VA. TAX REV. 631 (Spring 1993); Linda Galler, *Judicial Deference to Revenue Rulings: Reconciling Divergent Standards*, 56 OHIO STATE L. J. 1037 (1995); Paul Caron, *Tax Myopia, or Mammals Don't Let Your Babies Grow Up to be Tax Lawyers*, 13 VA. TAX REV. 517 (1994); Paul Caron, *Tax Myopia Meets Tax Hyperopia: The Unproven Case of Increased Judicial Deference To Revenue Rulings*, 57 OHIO ST. L. J. 637 (1996).

106. This article implicitly assumes that one would have appropriate standing to challenge the proposed regulation so that a substantive challenge could occur. However, the question of standing itself is a not so insignificant hurdle to a successful challenge.

107. *See* *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), for the general standard by which all agency actions are judged as either permissible or not permissible.

108. 26 U.S.C. § 7805(a) (1994) provides:

Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

109. *See* Prop. Treas. Reg. § 1.513-4, 58 Fed. Reg. 5690 (1993).

110. Generally, there are three types of tax regulations: (1) legislative regulations; (2) interpretive regulations; and (3) procedural regulations. Legislative regulations emanate from a specific and express statutory direction by Congress. Interpretive regulations emanate from the Treasury's § 7805(a) general regulatory power. Finally, procedural regulations are merely directive in nature.

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Theoretically, each of the various types of regulations is believed to be subject to a different standard of judicial review. For instance, legislative regulations are believed to be subject to the highest standard of review and, accordingly, are believed to have the force and effect of law. On the other hand, interpretive regulations are subject to a somewhat lower standard of review than legislative regulations. Reviewing courts ordinarily give strong deference to an agency's interpretive regulations.

111. *See generally* *Chevron v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

112. *Id.* at 843-44. Although the *Chevron* case deals with regulations promulgated by the Environmental Protection Agency, its reasoning is consistent with that found in cases involving the Treasury's rule-making authority. *See, e.g.*, *United States v. Vogel Fertilizer Company*, 455 U.S. 16 (1982); *Rowan Companies, Inc. v. United States*, 452 U.S. 247 (1981); *National Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472 (1979); *Fulman v. United States*, 434 U.S. 528 (1978); *O'Neill v. United States*, 410 F.2d 888 (6th Cir. 1969). *Accord* David F. Shores, *Deferential Review of Tax Court Decisions: Dobson Revisited*, 49 TAX LAWYER 629, 667 (Spring 1996).

113. *See, e.g.*, *National Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472 (1979) (concluding that treasury regulation interpreting the term "business league," which was not defined by Congress, as an organization whose activities are directed to improvement of business conditions of one or more lines of business is valid because it bears a fair relationship to the language and purposes of the statute); *Fulman v. United States*, 434 U.S. 528 (1978) (concluding that a treasury regulation adopting a rule of valuation of a distribution of appreciated property for purposes of the personal holding company tax was valid, especially given that Congress failed to provide for such a rule in the Internal Revenue Code).

114. *See, e.g.*, *United States v. Vogel Fertilizer Co.*, 455 U.S. 16 (1982) (concluding that a Treasury Regulation interpreting Congress' statutory definition of the term "brother-sister controlled group" to mean that each shareholder need not hold stock in each corporation was invalid as not being a reasonable interpretation of the statute in light of its language, structure, and legislative history); *Rowan Companies,*

Inc. v. United States, 452 U.S. 247 (1981) (concluding that treasury regulations interpreting Congress' statutory definition of "wages" in FICA and FUTA to include value of meals and lodging were invalid, for failing to implement statutory definition in a consistent or reasonable manner); *O'Neill v. United States*, 410 F.2d 888 (6th Cir. 1969) (concluding that a Treasury Regulation which interpreted Congress' existing definition of the term "corporation" so as to exclude certain state corporations was invalid and entitled to no weight because it was plainly inconsistent with the statute and constituted an attempt by the Treasury to legislate).

115. Commenting on this point, the Supreme Court has said that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer. *See* *Aluminum Co. of America v. Central Lincoln Peoples' Util. Dist.*, 467 U.S. 380 (1984).

116. 40 CFR § 51.165(a)(1)(i)&(ii) (1995).

117. Pub. L. No. 95-95, 91 Stat. 685 (1977).

118. *Chevron*, 467 U.S. at 839-40.

119. Pursuant to 40 CFR § 51.18(a)(1)(i)&(ii) (1995), "stationary source," and its related terms, are defined as follows:

(i) Stationary source means any building, structure, facility, or installation which emits or may emit any air pollutant subject to regulation under the [Clean Air] Act.

(ii) Building, structure, facility, or installation means all of the pollutant-emitting activities which belong to the same industrial grouping, are located on one or more contiguous or adjacent properties, and are under the control of the same person (or persons under common control) except the activities of any vessel.

120. Thus, an existing plant with several polluting devices could modify one such device without meeting the permit requirements if the modification did not increase overall emissions from the plant.

121. *See* *National Resources Defense Council, Inc. v. Gorsuch*, 222 U.S. App. D.C. 268, 685 F.2d 718 (1982). The appellate court recognized that the CAAA provision was silent as to Congress' definition of "stationary source" — both in the statute and in the legislative intent. Accordingly, the court looked

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to the purpose of the CAAA's nonattainment program for guidance. Although it believed that the "bubbling" concept of the regulation was mandatory for programs maintaining air quality, the appellate court held that "bubbling" was inappropriate for improving air quality. *Id.* at 276, 685 F.2d at 726.

122. The *Chevron* Court states:

[I]t is clear that the Court of Appeals misconceived the nature of its role in reviewing the regulations at issue. Once it determined, after its own examination of the legislation, that Congress did not actually have an intent regarding the applicability of the bubble concept to the permit program, the question before it was not whether in its view the concept is "inappropriate" in the general context of a program designed to improve air quality, but whether the Administrator's view that it is appropriate in the context of this particular program is a reasonable one.

Chevron, 467 U.S. at 845.

123. *Id.* at 842-43, provides:

When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

124. *Id.* at 843-44, states:

If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific

provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. Sometimes the legislative delegation to an agency on a particular question is implicit rather than explicit. In such a case, a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of the agency.

125. *Id.* at 851.

126. The Court states:

In these cases, the Administrator's interpretation represents a reasonable accommodation of manifestly competing interests and is entitled to deference: the regulatory scheme is technical and complex, the agency considered the matter in a detailed and reasoned fashion, and the decision involves reconciling conflicting policies. Congress intended to accommodate both interests, but did not do so itself on the level of specificity presented in this case. Perhaps that body consciously desired the Administrator to strike the balance at this level, thinking that those with great expertise and charged with responsibility for administering the provision would be in a better position to do so; perhaps it simply did not consider the question at this level; and perhaps Congress was unable to forge a coalition on either side of the question, and those on each side decided to take their chances with the scheme devised by the agency. For judicial purposes, it matters not which of these things occurred.

Id. at 865 (footnotes omitted).

127. *National Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472 (1979).

128. 26 U.S.C. § 501(c)(6) exempts from the federal income tax:

Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit

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of any private shareholder or individual.

129. Treas. Reg. § 1.501(c)(6)-1 provides:

A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons A stock or commodity exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of section 501(c)(6) and is not exempt from tax.

130. *National Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. at 475-476.

131. *Id.* at 476.

132. *Id.* at 481.

133. Generally, that definition provides that advertising is any message that promotes or markets a company's goods or services. *See generally* Prop. Treas. Reg. § 1.513-4(b), 58 Fed. Reg. 5690 (1993).

134. A court reviewing a regulation promulgated under 26 U.S.C. § 513 "need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction." *Chevron v. National Resources Defense Council, Inc.*, 467 U.S. at 843 n.11. Instead, the Treasury's construction "may not be disturbed as an abuse of discretion if it reflects a plausible construction of the plain language of the statute and does not otherwise conflict with Congress' expressed intent." *Rust v. Sullivan*, 500 U.S. 173, 184 (1991).

135. Under this approach, virtually all sponsorship payments would constitute UBTI. Accordingly, a charity's incentive for conducting charitable events would be severely limited.

136. While under this approach very few, if any, sponsorship payments would constitute UBTI, other side effects may hinder sponsorships of charitable events. For instance, although the proceeds to the charity may not be taxed as UBTI, they would likely lose their character as § 170 charitable contributions.

137. Regarding the complexity of the UBTI law in

particular one Congressman has said:

Mr. Chairman, as I stated in my testimony before the committee, it would be presumptuous of me to pose as an expert on tax laws and the various proposals for reforming our Revenue Code. I know that this subject is very complicated and technical.

See 115 Cong. Rec. H22733-34 (daily ed. August 7, 1969)(statement of Rep. Zablocki).

138. *Chevron*, 467 U.S. at 865.

139. In *Rust v. Sullivan*, the Court upheld Department of Health and Human Services (HHS) regulations that restricted abortion-related activities. The petitioners in *Rust* argued that "the regulations are entitled to little or no deference because they 'reverse a long-standing agency policy . . . ' and thus represent a sharp break from the Secretary's prior construction of the statute." 500 U.S. at 186.

140. *Id.*

141. *Chevron*, 467 U.S. at 863-864.

142. *National Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. at 485.

143. If an agency changes from a previous interpretation, the agency must provide a reasoned analysis for the change. However, if the new agency policy is supported by a reasoned analysis, it is entitled to no less judicial deference than the old policy. *See generally* Charles J. Cooper, et. al., *supra* note 105.

144. *Accord* Paul Streckfus, *Corporate Sponsorship Sellout Puts Integrity of IRS at Risk*, 60 TAX NOTES 1641 (Sept. 20, 1993).

145. This was true in the case of the Cadillac given to Duberstein in anticipation of future business referrals. *See* Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278 (1960).